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SUBJECT: Ontario Budget: Infrastructure Spending, Deficit, Both Increase

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1. (SBU) Summary: The Ontario government's 2009 budget introduces significant measures to help stimulate the province's ailing economy, including C\$27.5 billion in infrastructure spending, and the harmonization of the 8% provincial sales tax (PST) with the 5% federal goods and services tax (GST). Corporate and personal income tax reforms were also introduced to help stimulate investment in the province. This budget uses deficit spending in a way not seen since the recession of the 1990s, under the premiership of Bob Rae, and is projected to surpass even the largest provincial deficit during that period. This year's stimulus and predictions of future provincial deficits will result in a C\$56.8 billion deficit over seven years. End Summary.

Hard Times Call for Stimulus

2. (U) On March 26, the Ontario government's plan to spend its way out of recession was released in its C\$108.9 billion budget for the fiscal year beginning April 1. The province is struggling to offset the effects of the global economic downturn, and has pledged to spend C\$27.5 billion on infrastructure projects, featuring roads, schools and hospitals, over the next two years. This plan represents the province's largest two-year investment ever on infrastructure. The province's budget will be topped up with C\$5 billion from this year's federal budget. Ontario Premier Dalton McGuinty announced on March 23 that the province (with the help of the GOC) would spend C\$15.1 billion on infrastructure projects during the upcoming year, and another C\$17.4 billion in 2010-11.

3. (U) Transportation projects will receive the lion's share of spending over the next two years, at C\$9 billion, followed by health care at C\$7 billion, and education at C\$4 billion. The government estimates its spending will generate 146,000 jobs in 2009-10, and another 168,000 jobs in 2010-11. These are in addition to the estimated 85,000 jobs created in 2007-08, and 100,000 jobs created in 2008-09 as a result of Ontario's C\$18 billion investment in infrastructure over the past two years. However, from October 2008 to February 2009, Ontario lost 160,000 jobs, mostly in manufacturing, wiping out any job gains over that period. The province's unemployment rate rose to 8.7% in February, a full percent above the Canadian average. Employment numbers are not likely to improve as the province's GDP is expected to decline between 2.5% and 2.9% in 2009, followed by modest growth in 2010, between 1% and 2.3%.

Remember The Balanced Budget?

4. (U) The current budget year's deficit attracted much debate when

it was projected to be only C\$500 million (ref A); it now looks to be C\$3.9 billion. This year's stimulus-loaded budget proposal will dwarf that, putting the budget into a C\$14 billion deficit. This budget is on track to surpass the province's largest ever recorded deficit of C\$12.4 billion in 1993, during the last recession, when the NDP's Bob Rae ran the provincial government. The total forecasted deficit over seven years is C\$56.8 billion.

Sales Tax Harmonization

15. (U) One of the most contentious parts of the provincial March 26 budget is the harmonizing of Ontario's 8% provincial sales tax (PST) and the 5% federal goods and services tax (GST) into a 13% single sales tax, effective July 1, 2010. While sales tax harmonization is not popular with the general public, many industries favor the change because PST will be removed from business equipment and machinery, which is currently not subject to the GST. The Ontario government will provide middle and low income earners with a one-time rebate of up to C\$1000, spread out over a series of smaller payments, in order to soften the blow of the new tax to be imposed on previously PST-exempt goods and services, such as fast food meals, haircuts, and home heating fuels.

16. (U) Nearly half of Ontario's 2008-9 retail sales tax proceeds -- roughly C\$8 billion -- came from taxing business inputs. Under the harmonized sales tax regime, businesses are expected to save C\$4.5 billion over three years. Critics of the harmonization claim that it will only shift the tax burden from businesses to consumers. Market analysts estimate that the harmonized tax will save Ontario's businesses about C\$500 million a year in administrative costs alone. The GOC will provide C\$3 billion in transfer payments next year and

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another C\$1.3 billion in 2011 to facilitate the province's transition to the single sales tax. Business analysts have long called for tax reform in the province in order to make Ontario more attractive for new business investment. The tax harmonization is expected to move Ontario from a high-tax jurisdiction to a medium-tax jurisdiction by 2012, with the marginal tax rate on investment falling just over 10%.

Further Tax Reform

17. (U) The budget introduced further measures to encourage investment in Ontario, including cutting the corporate income tax rate from 14% to 12%, effective July 1, 2010, and to 10% by 2013. The rate paid by manufacturers and processors will be lowered from 12% to 10% on July 1, 2010. The provincial government will also cut the corporate tax rate for small businesses from 5.5% to 4.5%, effective July 1, 2010. The personal income tax rate was also lowered from 6.05% to 5.05%, beginning July 1, 2010, for the first C\$36,848 earned. The government estimates that under their proposed tax reforms, the total savings to individual consumers will be C\$10.6 billion over three years.

Revenue's Down, Spending's Up

18. (SBU) Ontario sales tax represents about 18% of the province's 2008-09 C\$93.4 billion total revenue stream, the second highest source of revenue after personal income tax (26%). A cyclical decline in sales tax revenue due to the economic downturn has resulted in a net drop in revenue for the province. Simultaneously, the province is presenting a stimulus-laden budget, resulting in a C\$18 billion combined two-year deficit. The 2009 budget forecasts C\$2 billion in new annual revenues starting in 2010, but it is unclear where the province will find additional revenue to finance ballooning healthcare spending, which was growing at 8% to 10% a year before the proposed stimulus was announced. Healthcare expenses cost Ontario C\$42.6 billion in 2008-09, roughly 40% of the province's total expenses, followed by education and training (19%),

and children's and social services (12%). For the first time in its history, Ontario will receive equalization payments from the federal government, worth C\$347 million in 2009-10. The province will spend C\$1.2 billion to build 4,500 new affordable housing units and to renovate 50,000 existing government-subsidized housing spaces to make them more energy efficient. This housing project is expected to create some 23,000 short-term jobs.

19. (SBU) Comment. While this budget results in the largest provincial deficit ever, most of the debate is centered on the harmonization of sales taxes. While many object to the predicted increase in Ontarians' cost of living because of the new consolidated tax, there seems to be little analysis of the long-term effect of the province's multi-year deficit projections. This is likely an acknowledgement that despite enthusiastic summaries about Canada's relative immunity from the global downturn, Ontario's economy has been hard-hit and will suffer further in the near-term. The provincial government is focused on ensuring its stimulus efforts result in job creation now, as well as preparing the province for a less industrial economic base sometime in the future.

NAY